

CREDIT OPINION

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Update

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City of Hartford, CT

Update - Moody's Downgrades Hartford, CT's GOs to Ba2 from Baa1; Outlook Remains Negative

Summary Rating Rationale

Moody's Investors Service has downgraded the City of Hartford, CT's general obligation debt rating to Ba2 from Baa1. The par amount of debt affected totals approximately \$550 million. The outlook remains negative.

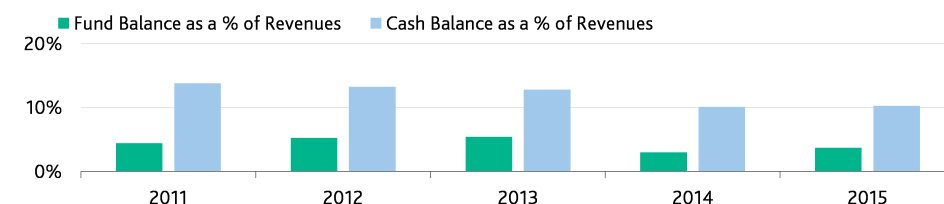
The downgrade to Ba2 reflects the challenges the city faces in achieving structurally balanced operations, closing its current year (fiscal 2017) budget gap and subsequent year projected shortfalls. The city has limited operating flexibility, exacerbated by weak and declining reserves and rising costs (including debt service and pension payments) over the next several years. The rating action also factors in narrowing liquidity and expansion of the current year budget gap since our last review.

The city's options for addressing the growing revenue/expenditure mismatch and eliminating the structural imbalance are limited with property tax revenue constrained by an already high tax rate and prospects for additional state aid limited by the state's own fiscal challenges. Further expenditure reductions will prove difficult after cuts in the current and prior fiscal years and extended negotiations with unions. We recognize that it has become increasingly unlikely that the city will be able to address its financial challenges on its own and, external assistance, either from the state or region will be needed.

The city's position as the state capital and regional economic and employment center is a positive credit factor; however, those strengths are offset, to some extent, by depressed wealth and income levels, and high tax payor concentration.

Exhibit 1

Narrow Fund Balance and Cash Levels



Fund and cash balances are for General Fund only.

Source: City's audited financial statements, Moody's Investors Service.

Credit Strengths

- » State capital and regional economic center
- » Trend of fully funding annual pension requirement

Credit Challenges

- » Lack of progress in addressing FY2017 budget gap and projected structural deficits in future fiscal years
- » Narrow liquidity and weak reserve levels
- » Historical reliance on one-time measures and nonrecurring revenues
- » High poverty and unemployment; low wealth
- » High debt burden with sharply escalating debt service payments in the next several years
- » Approximately half of property in city is owned by the state or non-profit institutions and thus tax-exempt
- » Significant exposure to state level financial challenges
- » Elevated tax payor concentration

Rating Outlook

The maintenance of the negative outlook reflects our expectation that the city will remain challenged to restore and maintain fiscal stability given the expected ramp up in expenditures including debt service and pension costs combined with modest revenue growth prospects.

The outlook also incorporates the city's significant reliance on state aid and the financial challenges that the state is facing which could adversely impact the city.

Factors that Could Lead to an Upgrade

- » Established trend of structurally balanced operations
- » Growth in reserves and liquidity resulting in greater financial flexibility
- » Substantial tax base growth and improvement in wealth and income levels of residents

Factors that Could Lead to a Downgrade

- » Continued lack of progress in addressing the current year and next year's budget gaps
- » Further weakening of liquidity
- » Further erosion of reserves
- » Overreliance on non-recurring revenue sources or one-time measures to balance operations
- » Deterioration in the city's tax base or demographic profile
- » State level financial weakness impacting state aid to the city
- » Loss of top taxpayer or employer

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

Hartford (City of) CT	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 7,713,608	\$ 7,147,578	\$ 6,526,349	\$ 6,888,294	\$ 6,877,951
Full Value Per Capita	\$ 61,820	\$ 57,242	\$ 52,256	\$ 55,099	\$ 55,154
Median Family Income (% of US Median)	51.9%	52.1%	52.2%	51.5%	51.5%
Finances					
Operating Revenue (\$000)	\$566,845	\$576,019	\$562,082	\$567,789	\$587,756
Fund Balance as a % of Revenues	4.4%	5.2%	5.4%	3.0%	3.7%
Cash Balance as a % of Revenues	13.8%	13.2%	12.8%	10.1%	10.3%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 384,689	\$ 416,195	\$ 577,326	\$ 532,676	\$ 585,063
Net Direct Debt / Operating Revenues (x)	0.7x	0.7x	1.0x	0.9x	1.0x
Net Direct Debt / Full Value (%)	5.0%	5.8%	8.8%	7.7%	8.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	1.0x	1.5x	1.7x	1.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	8.3%	12.6%	13.8%	14.6%

Note: Operating revenues, fund balance and cash balance metrics are for the General Fund only.

Source: City's audited financial statements, Moody's Investors Service

Recent Developments

The city's prospects for stabilization of its financial position in fiscal 2017 have worsened over the last six months. The fiscal 2017 budget (June 30, 2017 fiscal year-end) assumed \$16.5 million of employee concessions that, to date, have not materialized. Additionally, the city announced it is tracking additional unbudgeted expenditures in fiscal 2017. The city is also forecasting large deficits in fiscal 2018 and beyond.

Lastly, liquidity has weakened over last year, with the city recently announcing, absent any assistance or note issuance, it could deplete its cash as early as December. We believe the city's tentative plan to address this fiscal year's liquidity pressures through a note issuance, if other cash management measures are insufficient, is feasible. The weak cash flow forecasts, while manageable this fiscal year, signify a weakening financial position and loss of already limited flexibility.

Detailed Rating Considerations

Economy and Tax Base: Large, Regional Economic Center; Very Weak Income and Wealth Levels

The city's tax base will remain challenged by modest growth, low wealth and income levels, and high unemployment, which stood at 10.8% as of July 2016, significantly higher than the state (5.6%) and national rates (5.1%). While the city will continue to benefit from the stabilizing presence of state government, new job and tax base growth will likely remain sluggish.

The city's October 1, 2011 (effective fiscal 2013) revaluation, resulted in a 9.7% reduction in the city's grand list, with the largest value declines occurring in the city's commercial sector. The most recent revaluation date was October 1, 2016. Updated assessments figures are not yet available but the city expects some modest growth.

The tax base remains somewhat concentrated, with the top ten taxpayers representing 21.6% of the total taxable grand list value, consisting mainly of insurance companies, office buildings and utilities. The insurance industry remains an important part of the local economy including three of the top ten taxpayers and three of the top five employers. These include The Hartford Financial Services Group, Inc. (Baa2 stable), Aetna Inc. (Baa2 stable) and The Travelers Companies, Inc. (A2 stable). There is some uncertainty surrounding whether Aetna will remain in Hartford if its proposed merger with Kentucky-based Humana is completed. That merger is currently being challenged by the US Department of Justice.

The economy also benefits from its role as a regional health care center, with several hospitals and medical centers located in the city. The public sector in the greater Hartford region comprises nearly 15% employment, with employee growth in this sector limited due to challenges both at the city and state level.

New economic development will likely be modest in the coming years with a few small residential projects in various stages of development. The future of the city's largest project, the \$350 million "Downtown North" redevelopment effort, is uncertain as the cornerstone of this project, a new minor league baseball stadium, has been plagued by cost overruns, lawsuits, and delays. Given these issues, it is uncertain whether the other components of the revitalization plans which included 850 units of market rate housing, 180,000 square feet of retail space and parking will move forward in the near future.

The office vacancy rate in Hartford's Central Business District remains elevated. During the fourth quarter of 2015, vacancy rates in the central business district stood at 19.8%, up from 15.4% in 2014 and line with the 19.9% rate in 2013.

Income indices are very low as reflected in a median family income that is just 52% of the national average. Additionally, the poverty rate, which is currently at 33.6% (American Community Survey estimate), is more than twice the national rate and among the highest in the US. Hartford's \$55,154 full value per capita is 64% and 41% of the national and state averages, respectively. These low levels reflect not only weak housing values but the large amount of tax exempt government property.

Financial Operations and Reserves: Weak Reserves and Liquidity; Projected Budget Gap in Current and Upcoming Fiscal Years

The city will be challenged to restore financial flexibility and achieve structural balance in the coming years due to rising expenditures and limited ability to grow revenues. One-time measures and nonrecurring revenues (including sales of land, use of reserves and debt refinancings) have been used to balance the city's budgets over the last several years and are not sustainable. It is unclear how much more can be cut as the city has significantly reduced personnel (non-education) since 2000 with headcount down to 1,337 in fiscal 2017 from 1,964 in fiscal 2000. The fiscal 2017 budget alone eliminated 100 positions and had other departmental cuts. Revenues primarily consist of property taxes and state aid. While some development activity should provide for some tax base expansion, property tax revenue growth will be constrained by a very high tax rate with the mill rate having remained unchanged over the last five years. Intergovernmental aid, comprising nearly half of the city's revenue and composed mostly of state aid, has grown 17% from fiscal 2010 to fiscal 2015 (GAAP). However, state level financial pressures will limit growth in the coming years. The city is exploring solutions involving the state and greater Hartford region including increased state aid, a regional tax and shared service among municipalities. Many of the proposals require legislative approval and will likely face strong political opposition.

The fiscal 2014 budget represented a \$1.5 million reduction (0.3%) from the prior year, and was balanced with an \$8.3 million reserve appropriation and no increase to the tax rate. The budget included a \$13 million contribution to the retirement system from unidentified revenue sources. At year end, the city reported a \$13.5 million operating deficit, utilizing more reserves than appropriated. As a result, total General Fund balance decreased to \$16.9 million, or 3% of revenues, falling to the lowest level since fiscal 2009. Unassigned General Fund balance also declined to \$13 million, or 2.3% of revenues.

In fiscal 2015, the city added \$5 million to its General Fund balance resulting in available General Fund reserves of \$21.9 million, an improved, but narrow 3.7% of revenues. This compares unfavorably to the national median of 18% of revenues for similarly rated credits. The General Fund benefitted from a draw of \$3.8 million of reserves from the Board of Education (BOE) Actives Internal Service Fund and an inflow of \$14.4 million in non-recurring revenue related to the sale of a city-owned garage. In addition, the city elected to extend its pension funding schedule by 10 years which resulted in a decreased contribution of approximately \$3.2 million. Expenditure reductions included the elimination of 52 positions resulting in \$4 million in savings.

The fiscal 2016 budget relied on significant non-recurring items. The total budget represented a 3.3% decrease in spending over fiscal 2015 and did not include an increase to the property tax millage, which has not been raised since fiscal 2013, or use of fund balance. Notably, the budget relied on \$12.2 million in debt service savings from last fall's debt refunding and an additional draw of \$12.9 million from the BOE Actives Internal Service Fund. The budget also reflects the smoothing of a revised pension mortality table over the next four years with savings of \$2.3 million estimated in fiscal 2016. Budgeted expenditure reductions included \$3 million for health benefits, which rely on the city securing a lower cost contract in fiscal 2016, as well as eliminating 25 positions. The city

estimates a deficit in fiscal 2016 of \$9.6 million. Factors contributing to this potential deficit include a revenue shortfall of \$3.8 million, with \$1.9 million due to the sale of city property not materializing. On the expenditure side, the city projects public safety overtime running \$8.4 million greater than budgeted amounts. While this nearly \$10 million shortfall would represent under 2% of the budget, it would deplete 44% of the city's already narrow reserve levels, leaving fund balance at approximately \$11.9 million or 2.2% of revenues. These reserve levels would be well below the medians for similarly rated cities and towns and would further reduce the city's financial flexibility.

The fiscal 2017 budget represents a 3.6% increase in spending over the adopted fiscal 2016 budget and includes an \$8.4 million reserve appropriation and no increase in the mill rate. Budgetary growth drivers include health care costs, debt service, overtime, and contractual labor cost increases. The budget benefits from increased state aid and, for cost savings, relies on \$16.5 million of employee concessions as well as reductions in workforce and various departmental cuts saving nearly \$19 million. The budget also funds a portion of its pension obligation through conveyance of land. Although to a lesser extent than in fiscal 2016, the budget, as in past years, included one time measures, including appropriation of reserves, to address its operating challenges. With one quarter of the fiscal year complete, no employee concessions have been announced. Additionally, the city is tracking approximately \$6 million in unbudgeted expenditures in the current fiscal year related to an adverse lawsuit ruling against the city (of which \$4.7 million is potentially payable in fiscal 2017 however the judgment is subject to appeal) and increased debt service (\$1.4 million) on its minor league baseball team stadium project as offsetting revenues have not materialized due to project delays. Regarding the judgment, the amount and timing of completion of the appeals process is uncertain, potentially occurring in the next fiscal year.

In fiscal 2018, the city forecasts the structural gap will rise to nearly \$50 million (without employee concessions) due to a combination of sharply increasing costs and modest revenue growth. The largest expenditure increase is from debt service. Due to prior debt refinancings, annual debt costs will jump from \$30 million in the current fiscal year to \$45.6 million fiscal 2018, and to \$56 million in fiscal 2021. The city also forecasts an 11% rise in benefit costs in fiscal 2017 due to medical inflation and growth in pension contributions per the actuarial estimates. Further meaningful personnel cost cutting (non-education) will be difficult as the city has already implemented cuts over the last few years. With a draw on unbudgeted reserves likely in fiscal 2017, available fund balance levels will be minimal in fiscal 2018.

The city is looking at various strategies to provide budgetary relief over the next few years including additional debt refinancings or a restructuring of its pension liability (through the issuance of pension obligation bonds). These measures, if implemented, would not address the city's long-term structural mismatch between revenues and expenses. Measures that would address the long-term structural imbalance are largely outside of the city's control.

LIQUIDITY

Liquidity is weak and in mid-September the city indicated it may deplete its cash position as early as December of this year. The city makes monthly payments to the board of education however only receives state education aid three times a year in October, January and April. The city attributes the potential shortfall to the timing of receipt of state education aid which is distributed one month later in January. The city forecasts another potential liquidity crunch in March, right before the April education aid disbursement. While we expect the city to be able to issue some form of grant anticipation notes to address its near term cash flow issues over the fiscal year, the announcement underscores the city's weakening financial position and its reduced financial flexibility. Future reviews will review the city's liquidity and plans to address projected shortfalls. The city's depletion of reserves over the last several years has eliminated its ability to cover timing mismatches between revenues and expenses with internal resources.

The cash position at the close of fiscal 2015 in the General Fund was \$60.4 million or 10.3% of revenues.

Debt and Pensions: Increasing

Hartford remains highly leveraged, with a net direct debt burden of 9.3% (including debt issued in fiscal 2016) of equalized net grand list (ENGL), skewed somewhat upwards by the city's sizable tax-exempt sector. The city has had multiple refinancing transactions over the last few years that resulted in significant budgetary savings. As a result debt service levels in fiscal 2016, at approximately \$10 million, were very low. In the next five years, as discussed earlier, debt payments will rise significantly, putting fiscal pressure on the city.

The city has entered into a lease agreement with the Hartford Stadium Authority in which it is obligated to make about \$4.6 million in lease payments a year relating to approximately \$70 million of lease revenue bonds of the Authority for the construction of a minor league baseball stadium. The project has been plagued with delays and cost overruns with projected revenues to partially offset the lease payments not materializing in the current fiscal year. This has contributed to about \$1 million of the expanded budget shortfall.

Total fixed costs (required pension contributions, actual OPEB payments and debt service) in fiscal 2015 were moderate at 18% of operating revenues.

DEBT STRUCTURE

All of Hartford's debt is fixed rate. As a result of the city's debt restructurings over the last few years, principal amortization has slowed considerably with 56% of principal being repaid within 10 years. This is significantly below the state and US medians of 86% and 82%, respectively.

DEBT-RELATED DERIVATIVES

The city is not party to any interest rate swaps or other debt related derivatives.

PENSIONS AND OPEB

Hartford has a history of strong pension funding practices. The City Municipal Employee Retirement Fund (MERF) was almost fully funded in 2009 but declined marginally due to investment losses during the downturn. As of July 2015, the plan was funded at 77.6%.

The city has consistently funded its full annual required contribution for pension, as required under city charter. The city also maintains two smaller plans which are closed to new hires. The fiscal 2015 contribution for the city's pension plans was \$43.7 million (including education), or 7.5% of General Fund expenditures. Increasing contributions from the city's open MERF plan will likely be a source of incremental financial stress for the city over the coming years with required contribution projected to grow by more than 25% from fiscal 2017 to fiscal 2021. The city's 2015 adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is a sizeable \$923 million, or a well-above average 13.4% of ENGL, but a relatively moderate 1.6 times General Fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

The city has a large \$276 million other post-employment benefits liability (OPEB), with a \$21 million ARC which was funded at 62% in fiscal 2015. The plan is funded on a pay-as-you-go basis. Favorably, the city has set up an OPEB trust fund. Without the negotiation of employee concessions for OPEB, we do not anticipate the city will be able to make material progress in reducing the size of the unfunded OPEB liability over the medium term due to significant competing expenditure needs and ongoing revenue weaknesses.

Management and Governance

Hartford elected a new mayor in 2015. The new mayor and senior financial management has worked hard to address the structural imbalance that had materialized over preceding years but has acknowledged that a permanent solution will be difficult and may require resources that are largely outside of the city's direct control. Steps management has taken include more realistic budget assumptions and budget cuts in various departments.

Connecticut cities and towns have an institutional framework score of "Aa," or strong. Property tax revenues, which comprise about 44% of total General Fund revenues in fiscal 2015 are highly predictable and stable. At nearly 50% of revenues, Hartford derives a higher percent of revenues from state aid than most Connecticut municipalities. Cities benefit from high revenue-raising ability due to the absence of a statewide property tax cap. However, the low income and wealth levels of the population and high existing tax rates make sustained meaningful increases challenging. Expenditures primarily consist of personnel costs as well as education costs for those cities that manage school operations, and are highly predictable due to state-mandated school spending guidelines and employee contracts that dictate costs. Expenditure reduction ability is moderate as it is somewhat constrained by union presence.

Legal Security

The rated bonds are secured by the city's general obligation unlimited tax pledge.

Use of Proceeds

Not applicable.

Obligor Profile

Hartford is the state's capital and has an estimated population of 125,130 (American Community Survey estimates).

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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